

Lease agreements that contain purchase options that are equal to the fair market value of the tangible personal property at the end of the lease term are considered true leases, and the lessors incur Use Tax liability on their cost price of tangible personal property purchased for rental purposes. See 86 Ill. Adm. Code 130.2010. (This is a GIL).

September 24, 2002

Dear Xxxxx:

This letter is in response to your letter that we received on July 16, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be accessed at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

We at AAA lease office equipment (fax machines, copiers, etc) to businesses within your state. We purchase the equipment from a vendor who installs the equipment for us, as we are only the financing end of the transaction. When being invoiced by our vendors some are placing **maintenance, labor, installation, and freight** charges as separate line items. Others have it built into the cost of the equipment. Those vendors who separately state these charges on **their** invoice to us state that these items are not taxable because they are not considered part of the equipment or are 'soft costs'. We want to abide by your tax laws therefor we are requesting a legal opinion as to how these services should be taxed. I am enclosing a copy of our standard lease agreement along with an example of a invoice and definitions of our lease types for your reference. Please provide or reference any of your statutes that relate to this matter, so we have documentation to provide to our vendors and lessees. Thank you for your cooperation in this matter. If you have any questions please contact me at the above phone number or address.

For general informational purposes we refer you to 86 Ill. Adm. Code 130.2010, the Department's regulation that covers the taxation of leases. The copy of your standard lease agreement and definitions of lease types that you appended to your letter shows that your transactions can be either true leases or conditional sales. Under Illinois law, "true leases" and "leases" that are actually conditional sales contracts are treated differently for Retailers' Occupation and Use Tax purposes.

Lessors under true lease agreements are subjected to a Use Tax on their cost price or acquisition value of tangible personal property that they use by leasing in Illinois. This means lessors encounter a front-end tax on value rather than an amortized tax on receipts. The only exception is automobiles rented for one year or less, which are subject to the Automobile Renting and Use Tax found at 35 ILCS 155/1 et seq.

When lessors buy rental items for true leases from suppliers registered to collect Illinois tax, the supplier incurs a Retailers' Occupation Tax liability upon the gross receipts and the purchaser incurs the complementary Use Tax. The retailer collects this Use Tax from the customer, which, in effect, reimburses the retailer for its Retailers' Occupation Tax liability. If a lessor purchases rental items for true leases from suppliers who do not collect the Illinois tax, the purchaser is required to self-assess the Use Tax and pay it directly to the Illinois Department of Revenue.

True leases generally have no buy out provisions at the close of the leases. If buy out provisions do exist, they must be fair market value buy out options in order to maintain the character of the true leases. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See, 86 Ill. Adm. Code 130.220(a). As end users of tangible personal property located in Illinois, lessors incur Use Tax liability on their cost price of such property. Except for short-term automobile rentals, there is no tax due upon rental receipts in Illinois.

Under Section 130.2010(a), persons who purport to "lease" the use of property, but in fact sell such tangible personal property to nominal "lessees," are considered to be making conditional sales subject to Retailers' Occupation Tax. Such would be the case when the agreements contain nominal purchase options at the end of the lease term. In these situations Retailers' Occupation Tax is due on all the payments received by the "lessors." Interest or finance charges may be excluded from gross receipts if the books of the retailers ("lessors") clearly reflect the amounts of the payments attributable to financing. See 86 Ill. Adm. Code 130.420.

Persons who purchase items for resale under conditional sales contracts can avoid paying tax to suppliers by providing certificates of resale that contain all the information set out at 86 Ill. Adm. Code 130.1405, enclosed. As noted above, all receipts under conditional sales transactions would be taxable.

For purposes of the following responses, we have assumed the agreement with your customers is a true lease. Under true leases the lessor incurs Use Tax upon its cost price of the rental property. This amount is the gross receipts paid to its vendor and generally means the consideration for a sale valued in money whether received in money or otherwise, including cash, credits, property, and services, but not including the value of or credit given for traded-in tangible personal property where the item that is traded-in is of like kind and character as that which is being sold, and shall be determined without any deduction on account of the cost of the property sold, the cost of materials used, labor or service cost or any other expense whatsoever. See 35 ILCS 105/1 and 3-10, and 120/1. Labor charges are costs of doing business and are not deductible from retailers' gross receipts in computing the tax. The segregation of these charges as a separate line item on the invoice does not create a different result. See 86 Ill. Adm. Code 130.410, enclosed.

Whether freight charges may be deducted by retailers in calculating Retailers' Occupation Tax liability depends not upon the separate billing of such freight or delivery charges but upon whether the charges are included in the selling prices of the property or are separately contracted for and the charges are actually reflective of the costs of shipping. To the extent the freight or delivery charges exceed the costs of shipping, the charges will be subject to tax. The best evidence that freight or delivery charges were agreed to separately and apart from selling prices, are separate and distinct contracts for freight or shipping. Alternatively, documentation in the records of sellers that purchasers had options of taking delivery of the property at sellers' locations, for the agreed purchase prices, or having delivery made by sellers for the agreed purchase prices plus ascertainable delivery charges, may suffice.

In addition, where the seller engages in the business of selling tangible personal property at retail, and such tangible personal property is installed by the retailer, the receipts from such installation charges must be included in the gross receipts upon which tax is measured if such installation charges are included in the selling price of the property being sold. See, 86 Ill. Adm. Code 130.450, enclosed.

If, however, the seller and buyer enter into a separate agreement for the installation charges separately from the selling price of the tangible personal property which is sold, then the receipts from the installation charges are not a part of the "selling price" of the tangible personal property which is sold. A separate agreement would include an invoice that separately lists the installation charge and is also signed by the customer.

Please be advised that charges for maintenance agreements that are included in the selling price of tangible personal property are part of the gross receipts of sale that are subject to tax. However, maintenance agreements that are not included as part of the selling price of tangible personal property but are sold as separate agreements for predetermined fees are not part of the gross receipts of sales that are subject to Retailers' Occupation and Use Tax liability. The servicemen that provide service under the separate maintenance agreements are required to pay Use Tax to their suppliers on their cost price of the tangible personal property that is transferred incident to the completion of the maintenance agreements. See 86 Ill. Adm. Code 140.301(b)(3), enclosed.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Karl W. Betz
Associate Counsel

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